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No. 83-

In The

Supreme Court of the United States

October Term, 1983

JOSEPH A. MOLLER and DOROTHY D. MOLLER,
Petitioners,

v.

THE UNITED STATES,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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QUESTIONS PRESENTED

1. Whether investing in securities can, under appropriate circumstances, constitute a trade or business for the purpose of the deduction of the expenses of an office in the home under § 280A of the Internal Revenue Code (26 U.S.C. § 280A), where the investors:

(a) devote their full time and attention to their investments;

(b) engage in numerous securities transactions; and

(c) realize substantial and annually increasing ordinary income.

2. Whether a distinction between a "trader" in securities and an "investor" in securities is appropriate under § 280A in view of:

(a) the legislative history of § 280A;

(b) the conflict among the courts as to the test of a trade or business in connection with securities investments; and

(c) the conflict among the courts as to the definition of trade or business.

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v.

THE UNITED STATES,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

Petitioners Joseph A. and Dorothy D. Moller respectfully pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Federal Circuit entered in the above-entitled case on November 18, 1983.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 721 F.2d 810 (C.A. Fed. 1983) (Appendix A hereto). The Opinion of the Claims Court is reported at 553 F. Supp. 1071 (Cl. Ct. 1982) (Appendix B hereto).

JURISDICTION

The judgment of the Court of Appeals for the Federal Circuit was entered on November 18, 1983. A timely Petition for Rehearing in banc was denied by order dated December 13, 1983 (Appendix C hereto), and this Petition for Certiorari has been timely filed within 90 days of that date. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

In enacting § 280A of the Internal Revenue Code, Congress strongly implied that under appropriate circumstances investing in securities constitutes a trade or business for the purpose of the home office deduction permitted by that section.[1] No case of investing better demonstrates the appropriate circumstances than the present one.

I. *Statute Involved*

This case involves § 280A of the Internal Revenue Code (26 U.S.C. § 280A) (Appendix D hereto). Section 280A(c)(1)(A) specifically allows the deduction of expenses allocable to a portion of a residence exclusively used on a regular basis "[as] the principal place of business for any trade or business of the taxpayer[.]"

Section 280A was added to the Internal Revenue Code to provide an objective standard to distinguish deductible business expenses from nondeductible personal living expenses, and to "curb widespread abuses" associated with home office deductions.[2] The Congressional intent has always been to tax only net income. Business expenses must be deducted to calculate the taxpayer's net

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[1]S. Rept. 94-938 (1976), 1976-3 C.B. (Vol. 3) 49, 187; H. Rept. 94-658 (1975), 1976-3 C.B. (Vol. 2) 695, 853.

[2]S. Rept. 94-938, *supra*, 1976-3 C.B. (Vol. 3) at 185.

income — total earnings less the expenses incurred in producing them.[3] Section 280A reflects the general policy of the Internal Revenue Code that personal expenses are not deductible because they represent the disposition taxpayers choose to make of money they have previously earned.[4]

II. *Operative Facts*

Petitioners Joseph and Dorothy Moller have relied almost exclusively on their investments for their livelihood since 1965. Their only other sources of income have been two small pensions and social security (R.A. 257).[5]

During 1976 and 1977, the two taxable years in question, Petitioners each devoted from 40 to 42 hours per week to their investment activities (R.A. 269). In 1976, Petitioners conducted 124 securities transactions having a total dollar volume of $3,524,482 (R.A. 266–268). In 1977, they consummated 106 transactions for a total dollar volume of $1,779,101 (R.A. 266–268).

Petitioners conducted their investment activities entirely in the home office they maintained and used solely for this purpose (R.A. 261, 273). Petitioners never used their office for personal purposes, and an office was unquestionably necessary in connection with their investment activities (R.A. 261, 273). In fact, the IRS twice conceded in writing that Petitioners' extensive investment activities required an office (R.E. 185, 188).[6]

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[3] *Commissioner v. Tellier*, 383 U.S. 687, 691, 86 S. Ct. 1118, 1120, 16 L. Ed. 2d 185 (1965).

[4] *James v. United States*, 308 F.2d 204, 206 (9th Cir. 1962).

[5] "R.A." references are to the separately bound two-volume record appendix, including transcript of proceedings before the Claims Court, filed in connection with the appeal to the Court of Appeals below.

[6] "R.E." references are to the separately bound four-volume record appendix of exhibits filed with the Court below.

In 1976 and 1977, Petitioners actively managed four separate portfolios of stocks and other securities (R.A. 264). Their investment activities produced $543,265 in taxable income in 1976, and $590,762 in 1977 (R.A. 265). Petitioners' federal income tax in these two years was $297,745 and $316,721, respectively (R.A. 265). Petitioners' gross taxable income has increased each year, so that by 1981 it exceeded $1,000,000 (R.A. 266).

Petitioners' securities sales also produced substantial capital gains. In 1976, their gains were $63,335.35 (R.E. 122). In 1977, they were $165,847.17 (R.E. 132). However, Petitioners intentionally reduced or eliminated taxable gain by selling selected stocks whose value had decreased (R.A. 122–123).

Petitioners never sought outside advice regarding their investments or transactions (R.A. 269). In making decisions to buy, sell or hold a particular stock, Petitioners studied the market, the corporations in which they invested or intended to invest, as well as the performance of these corporations' products and stock (R.A. 269). In 1976, the total value of all stocks and securities Petitioners held was approximately $13,500,000 (R.A. 265). In 1977, it was approximately $14,500,000 (R.A. 265). By 1982, the value had grown to about $25,000,000 (R.A. 57).

Petitioners' expenses for their office were $7,439.65 in 1976, and $7,247.21 in 1977 (R.A. 272). They deducted these sums under § 280A in filing their 1976 and 1977 federal income tax returns (R.A. 268). The IRS audited Petitioners for both years, disallowed these deductions, and assessed income tax deficiencies and interest (R.A. 263). Petitioners paid these amounts and filed claims for refund which were disallowed (R.A. 263). Petitioners then brought suit in the United States Claims Court pursuant to 28 U.S.C. §§ 1346 and 1491 to recover the taxes paid, plus interest.

III. *Proceedings Below*

Respondent argued in the Claims Court that Petitioners' home office deductions were not allowable because their investment activities were not a trade or business. The Claims Court disagreed. It found Petitioners' regular, extensive and continuous investment activities were a trade or business and distinguished Petitioners from mere passive or inactive investors.

The Court of Appeals reversed on the ground Petitioners did not make short-swing securities sales. They were thus not "traders," who the Court said are in a trade or business, but "investors" who are not.

Other Circuits have not drawn the distinction of the Court below in determining if a taxpayer's investment activities are a trade or business. Instead, they have examined the level of the activity and have distinguished between passive and active investors. Moreover, the Court of Appeals' conclusion is founded on an incorrect application of a decision by this Court, *Higgins v. Commissioner*, 312 U.S. 212, 61 S. Ct. 475, 85 L. Ed. 783 (1941).

The inevitable result of the Court of Appeals' restrictive application of § 280A is to deny the deduction of expenses which are in no way personal, and to undermine the fundamental and long-standing Congressional policy of allowing the deduction of legitimate business expenses.

REASONS FOR GRANTING THE WRIT

I. *The Court of Appeals' Decision Improperly Extends This Court's Decision in* Higgins *To Deny Trade Or Business Status Under Entirely Different Facts And Circumstances. It Therefore Presents An Important Question Which This Court Should Settle.*

A. *The Court of Appeals' Decision Conflicts With The Legislative History of Section 280A.*

The Court of Appeals found Petitioners' substantial and full-time investment activities were not a trade or business. In so doing, the Court distinguished between "traders" and "investors." 721 F.2d at 813. This conclusion ignores the legislative history of § 280A.

In *Snow v. Commissioner*, 416 U.S. 500, 94 S. Ct. 1876, 40 L. Ed. 2d 336 (1974), this Court pointed out that since the words "trade or business" appear in varying contexts in about 60 different Internal Revenue Code sections, other Code sections are not helpful in determining the meaning of these words under any particular section. 416 U.S. at 503, 94 S. Ct. at 1878. The plainest indication of their meaning under § 280A is the Senate Finance Committee Report on this very section. The Report states in part:

> For example, no deduction will be allowed if a taxpayer *who is not in the trade or business of making investments*, uses a portion of his residence (exclusively and on a regular basis) to read financial periodicals and reports, clip bond coupons and performs similar activities because the activity is not a trade or business.[7]

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[7]The House Ways and Means Committee Report also contains the language limiting the disallowance of a deduction to a taxpayer "who is not in the trade or business of making investments." H. Rept. 94-658, *supra*, 1976-3 C.B. (Vol. 2) at 853.

S. Rept. 94-938, *supra*, 1976-3 C.B. (Vol. 3) at 187. (Emphasis added.)

Under proper circumstances, investors can thus be in a "trade or business" under § 280A. In *Curphey v. Commissioner*, 73 T.C. 766 (1980), the Tax Court specifically found this to be the case because the Senate Report indicated the "disallowance of a deduction was intended to apply to a taxpayer 'who is not in the trade or business of making investments,' thereby implying that under appropriate circumstances, such type of activity could constitute a trade or business." 73 T.C. at 771.

The social evil which § 280A was enacted to correct was the tax deduction obtained by taxpayers for the use of their homes to perform minor activities. In the investment area, § 280A was intended to eliminate coupon clipping and periodical reading as the basis for a deduction. The task under § 280A is therefore to determine what is coupon clipping and what is truly investment work. Petitioners' position is simply that when a person devotes over 40 hours per week to investment work and has over 100 securities transactions per year, this is not coupon clipping.

Neither § 280A nor its legislative history distinguishes between a "trader" and an "investor" in determining which is entitled to the deduction. To the contrary, the emphasis in both the Senate and the House Reports is on "making investments," and not trades.[8] This indicates that investing can qualify under the proper circumstances. No case could better demonstrate these circumstances than the present one.

The Court of Appeals' distinction between "investors" and "traders" under § 280A discriminates against active investors and conflicts with the Congressional in-

[8] S. Rept. 94-938, *supra*, 1976-3 C.B. (Vol. 3) at 187; H. Rept. 94-658, *supra*, 1976-3 C.B. (Vol. 2) at 853.

tent plainly set forth in that section's legislative history. This conflict justifies the grant of certiorari to review the judgment of the Court of Appeals.

B. *The Court of Appeals' Decision Imposes An Unwarranted* Per Se *Rule Which Conflicts With The Test Laid Down By This Court In* Higgins.

The Court of Appeals below cited this Court's decision in *Higgins, supra,* for the proposition that:

> A taxpayer who merely manages his investments seeking long-term gain is not carrying on a trade or business. This is so irrespective of the extent or continuity of the transactions or the work required in managing the portfolio. *Higgins v. Commissioner,* [citation omitted].

721 F.2d at 814.

But the Court of Appeals did not quote the key language of *Higgins:*

> To determine whether the activities of a taxpayer are "carrying on a business" requires an examination of the facts in each case.

312 U.S. at 217, 61 S. Ct. at 478.

This Court in *Higgins* did not declare that substantial securities transactions do not constitute a trade or business. The taxpayer in *Higgins* purchased only four lots of tax-exempt bonds and made absolutely no sales. *Higgins v. Commissioner,* 111 F.2d 795, 796 (2d Cir. 1940). This is in contrast to Petitioners' 124 transactions in 1976, and 106 transactions in 1977, for total dollar values of $3,524,482 and $1,779,101, respectively.

In *Higgins,* the taxpayer was inactive. He "merely kept records and collected interest and dividends from his securities, through managerial attention for his invest-

ments." 312 U.S. at 218, 61 S. Ct. at 478. Such facts simply did not constitute a trade or business and were "not sufficient as a matter of law to permit the courts to reverse the decision of the Board." *Id.*

Petitioners submit that the Court of Appeals below has imposed a rule which conflicts with *Higgins* and creates new law. The issue whether substantial securities investment activities constitute a trade or business is an important question which should be settled.

II. *The Lower Courts Have Had Great Difficulty In Applying The* Higgins *Test To More Complicated Cases And Require Assistance. Clarification By This Court Is Therefore Necessary.*

Numerous Circuit Courts have cited the *Higgins* test in connection with widely varying holdings. However, *Higgins* has also been cited for its failure satisfactorily to define the term "trade or business." In short, *Higgins* has been cited to support conclusions which cannot be reconciled with each other or with the *Higgins* case itself. The conflicts between these cases and *Higgins*, and among the cases themselves, are graphically illustrated by the following discussion and the chart attached hereto as Appendix E.

A. *The* Higgins *Test Has Been Rejected Or Found Unsatisfactory By Lower Courts.*

Recently, the Second Circuit in *Gajewski v. Commissioner*, 723 F.2d 1062 (2d Cir. 1983), rejected the *Higgins* "facts and circumstances" test because it "does not describe a standard at all . . . ." 723 F.2d at 1066. The Court declared: "To describe 'facts and circumstances' as a test is therefore to adopt a misnomer; the phrase amounts to a non-test." *Id.*

Gajewski instead adopted the "goods or services" test, based on Justice Frankfurter's concurring opinion

in *Deputy v. Du Pont*, 308 U.S. 488, 499, 60 S. Ct. 363, 369, 84 L. Ed. 416 (1940): " 'carrying on a trade or business,' . . . involves holding one's self out to others as engaged in the selling of goods or services."

In *Helvering v. Wilmington Trust Co.*, 124 F.2d 156 (3d Cir. 1941), *rev'd on other grounds*, 316 U.S. 164, 62 S. Ct. 984, 86 L. Ed. 1352 (1942), the Third Circuit also adopted the "goods or services" test. The Court observed that *Higgins* left the application of this test "in some confusion," but concluded that *Higgins* did not necessarily detract from the test. 124 F.2d at 159. The Third Circuit later expressly adopted the "goods or services" test in *McDowell v. Ribicoff*, 292 F.2d 174 (3d Cir. 1961), finding *Higgins* contained no definition of "trade or business." 292 F.2d at 176–77.

The Fourth Circuit has not rejected the *Higgins* test, but has found it difficult to apply. *Walsh v. Commissioner*, 313 F.2d 389 (4th Cir. 1963), declared that determination of what is a trade or business "has been made difficult because . . . the decisions fail to define satisfactorily the term 'trade or business.' Higgins v. Commissioner [citation omitted]." 313 F.2d at 391.

Two Circuits have thus rejected the *Higgins* test, and a third has found it unsatisfactory. Clarification of the test by this Court is therefore appropriate.

B. *The Rejection Of The* Higgins *Test By Lower Courts Has Produced Conflicts Among the Circuits.*

Although *Gajewski, supra*, held a professional gambler is not in a trade or business under the "goods or services" test, it noted that a "professional investor" is in a trade or business because he "does offer goods to others in the sense that he buys and sells securities. See *Fuld v. Commissioner*, 139 F.2d 465, 468–69 (2d Cir.

1943); *Levin v. United States*, 597 F.2d 760, 765 (Ct. Cl. 1979); *Purvis v. Commissioner*, 530 F.2d 1332, 1334 (9th Cir. 1976)." 723 F.2d at 1067, n.8.

Gajewski cited several Circuit Courts which have "implicitly or explicitly" adopted the "goods or services" test. Among them was *Wilmington Trust Co., supra*, which involved substantial securities activities that would plainly constitute a trade or business under *Fuld, Levin* and *Purvis*. However, the Third Circuit in *Wilmington Trust Co.* reached the opposite conclusion from *Gajewski* because it found securities transactions do not meet the "goods or services" test. 124 F.2d at 159.

The Fourth Circuit has followed the *Higgins* test. *Commissioner v. Nubar*, 185 F.2d 584 (4th Cir. 1950), declared *Higgins* had "pointed out that whether the activities of a taxpayer constitute 'carrying on a business' requires an examination of the facts in each case," and held a taxpayer's substantial securities activities were a trade or business. 185 F.2d at 588.

The Court of Appeals below adopted the body of law of the Court of Claims.[9] In *Levin, supra*, the Court of Claims cited *Higgins* for the proposition that "a factual analysis in each case is required to determine if a particular taxpayer's securities activities rise to the level of 'carrying on a business.' " 597 F.2d at 765.

The Court of Appeals below did not apply the "goods or services" test. It also ignored the *Higgins* "facts and circumstances" test in concluding Petitioners were not in a trade or business. This was based in part on the Ninth Circuit's decision in *Purvis, supra*, which incorrectly interpreted *Higgins* as the "leading case which distinguishes between trading and investing." 530 F.2d at 1333. No such distinction can be found in *Higgins*.

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[9]*South Corporation v. United States*, 690 F.2d 1368 (C.A. Fed. 1982).

The Second and Third Circuits have thus rejected the *Higgins* test but do not agree whether securities transactions meet the "goods or services" test. However, the Fourth and Federal Circuits have followed the *Higgins* test to find securities transactions to be a trade or business. The Court of Appeals below followed neither test. There is accordingly great confusion in the lower courts as to the application of *Higgins*. This Court's clarification and guidance are therefore necessary.

III. *The Conflicting Tests Applied By Courts Of Appeals Regarding The Important Question Of What Constitutes A Trade Or Business Require Clarification By This Court.*

Beginning in 1939 and continuing to the present, the Circuits have developed at least four inconsistent tests, each of which has been applied to the case of an investor, to determine what constitutes a trade or business.

A. *Trade Or Business Requires An Examination Of The Facts In Each Case.*

This test was enunciated in *Higgins, supra*, and has been followed in the Fourth, Fifth, Sixth and Seventh Circuits, and in the Court of Claims. *See Nubar, supra*, 185 F.2d at 588; *Mayrath v. Commissioner*, 357 F.2d 209, 212 (5th Cir. 1966); *Main Line Distributors, Inc. v. Commissioner*, 321 F.2d 562, 565 (6th Cir. 1963); *Simonsen Industries v. Commissioner*, 243 F.2d 407, 408 (7th Cir. 1957).

B. *Trade Or Business Requires Holding One's Self Out To Others As Selling Goods Or Services.*

The "goods or services" test was suggested by Justice Frankfurter's concurring opinion in *Deputy v. Du Pont, supra*, and has been followed in the Second, Third

and Fifth Circuits and, to a limited extent, in the Ninth Circuit. *See Gajewski, supra,* 723 F.2d at 1066; *Wilmington Trust Co., supra,* 124 F.2d at 158; *Commissioner v. Burnett,* 118 F.2d 659, 660 (5th Cir. 1941); *Daily Journal v. Commissioner,* 135 F.2d 687, 688 (9th Cir. 1943).

C. *Trade Or Business Requires "Extensive, Varied, Continuous And Regular" Activities.*

This test was first declared in *Kales v. Commissioner,* 101 F.2d 35, 39 (6th Cir. 1939), where the Sixth Circuit distinguished a mere investor from an active investor in a trade or business. Numerous decisions have either implicitly or explicitly recognized the same distinction. *See Higgins, supra,* 312 U.S. at 218, 61 S. Ct. at 478; *Nubar, supra,* 185 F.2d at 588; *Burnett, supra,* 118 F.2d at 660; *Maloney v. Spencer,* 172 F.2d 638, 640 (9th Cir. 1949); *Levin, supra,* 597 F.2d at 765; *Skoglund v. United States,* 82-1 U.S.T.C. ¶ 9270 (Ct. Cl. 1982).

Levin distinguished the passive nature of the *Higgins* taxpayer's investments: "In contrast to the distant management of a portfolio portrayed in *Higgins*, judgments regarding purchases and sales were made directly by taxpayer . . . ." 597 F.2d at 765.

Likewise, this Court in *Higgins* impliedly found the taxpayer to be a mere passive investor when it stated the Board of Tax Appeals had "appraised the evidence here as insufficient to establish petitioner's activities as those of carrying on a business." 312 U.S. at 218, 61 S. Ct. at 478. "The petitioner merely kept records and collected interest and dividends from his securities . . . ." *Id.*

Skoglund concerned whether 15 hours a week of investment activity constituted a trade or business. The Court of Claims found it did not because "it is difficult for an individual's investment activity to rise to a level that constitutes a trade or business." The Court did not

recognize a rule that investment activity is *never* a trade or business. The taxpayer's limited activities, as in *Higgins*, simply did not meet the test.

In *Kales*, the Court distinguished a "mere" investor from one in a trade or business, declaring the latter is characterized "by the number, continuity and regularity of his transactions and the time, energy and organization devoted to them." 101 F.2d at 38.

The Court of Appeals below found that " 'the decision in *Kales* was impliedly if not expressly disapproved in *Higgins* * * * .' *Goodyear Investment Corp. v. Campbell*, 139 F.2d 188, 191 (1943)." 721 F.2d at 814. However, even an implied disapproval is not apparent on a fair reading of *Higgins*, and *Kales* continued to be cited after *Higgins* as a case defining a trade or business. See *Burnett, supra*, 118 F.2d at 660; *Maloney, supra*, 172 F.2d at 640.

In any event, cases long after *Kales* stated a virtually identical test. *McDowell v. Ribicoff, supra*, declared that "trade or business" refers not only to activities engaged in for profit, "but to extensive activity over a substantial period of time during which the taxpayer holds himself out as selling goods or services." 292 F.2d at 178. *Stanton v. Commissioner*, 399 F.2d 326 (5th Cir. 1968), quoted the above language from *Ribicoff*, and *Gajewski* in turn endorsed both *Ribicoff* and *Stanton*. 723 F.2d at 1066. The only meaningful distinction between this test and the *Kales* test is the additional "goods or services" requirement, which *Gajewski* declares a "professional investor" meets. 723 F.2d at 1067, n.8.

D. *Trade Or Business Requires That One Be A "Trader" Rather Than An "Investor."*

This test was declared by the Court of Appeals below. To a limited extent this test was suggested in the Ninth Circuit, although the case did not involve an active

investor, and to some extent in the Court of Claims, where the taxpayer was an active investor and in a trade or business. See *Purvis, supra,* 530 F.2d at 1333; *Levin, supra,* 597 F.2d at 765.

E. *Investors Are Entitled To Know Which Test Is Correct.*

In view of the confusion among the various Courts of Appeals beginning with the *Kales* decision in 1939, and ending with the instant case and *Gajewski* in November and December of 1983, this area of the law requires the guidance of this Court. Petitioners submit that the Court of Appeals' ruling is not only in conflict with decisions of this Court and other courts cited above, but that the issue of what constitutes a trade or business in the context of investment activities is a question of growing importance which should be definitively settled.

IV. *The Court Of Appeals' Decision Creates New Trade Or Business Criteria Which Will Cause Havoc In The Administration Of Our Tax Laws. Clarification By This Court Is Therefore Necessary.*

The Court of Appeals below found it significant whether a taxpayer intends to be a short-term trader or a long-term investor. It also found the nature of the profit derived from the activities important. Short-term capital gains thus qualify the taxpayer's activities as a trade or business, while long-term capital gains, appreciation in portfolio values, and annually increasing dividends and interest will not.

The Court's distinction between a "trader" and an active "investor" is contrary to the intent of § 280A, and is inconsistent with *Higgins* and other Courts of Appeals. It is indisputable under any definition of trade or business that its basic purposes are to produce an increased annual profit and increase the value of the business. An enter-

prise which accomplishes this year after year is universally said to be a successful business.

Between 1971 and 1981, Petitioners' annual gross taxable income increased from $335,000 to over $1,000,000, or an increase of about 300%. From 1976 through March, 1982, Petitioners' investment work increased the value of the securities they managed from $13,500,000, to $25,000,000. This is an increase of 84%, and occurred before the bull market which began in August of 1982.

The above figures constitute the bottom line of Petitioners' business. They demonstrate that Petitioners were not only active investors, but tremendously successful investors who ran a highly profitable business. To conclude that only a trader is in a trade or business, and an active investor is not, is to establish an irrational, unjustified distinction without a difference.

The Court's distinction between traders and investors would also encourage abusive manipulation of securities holdings to obtain the § 280A deduction. If a taxpayer needs only to engage in an unspecified number of short-term sales to be a "trader," and thus be entitled to a home office deduction, this is precisely what many creative taxpayers will do under the holding of the Court below.

The label applied to the activity should not determine whether that activity qualifies as a trade or business. Rather, the inquiry should be directed to the level of the taxpayer's activities and whether those activities are sufficiently extensive, varied, continuous and regular to qualify as a bona fide trade or business. An active, full-time investor is in a trade or business and a person who merely clips coupons and passively receives income from investments is not. The only standard that can be fairly

and adequately administered under our tax laws is the one which distinguishes between an active and a passive investor.

CONCLUSION

The Court of Appeals' opinion poses important and recurring questions of taxation relating both to the reach of this Court's decision in *Higgins*, as well as the definition and tax treatment of business under § 280A of the Internal Revenue Code. A writ of certiorari should issue to review the judgment and opinion of the Court of Appeals for the Federal Circuit.

Respectfully submitted,

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Joseph A. & Dorothy D. MOLLER,
Plaintiffs-Appellees,

v.

The UNITED STATES,
Defendant-Appellant,

Appeal No. 83-870.

United States Court of Appeals,
Federal Circuit.

Nov. 18, 1983.

Before KASHIWA, Circuit Judge, NICHOLS,* Senior Circuit Judge, and NIES, Circuit Judge.

KASHIWA, Circuit Judge.

This is an appeal by the United States from a judgment of the Claims Court granting taxpayers, Joseph A. and Dorothy D. Moller, a tax refund for the years 1976 and 1977. 1 Cl.Ct. 25, 553 F.Supp. 1071 (1982). The Claims Court concluded that taxpayers were active investors engaged in the "trade or business" of making investments and held that taxpayers were entitled to deduct the expenses of two home offices under I.R.C. § 280A. For the reasons stated below, we reverse.

FACTS

Since 1965 taxpayers have relied almost entirely on the income derived from their investments for their support. Their only other sources of income have been two small pensions and social security payments.

The Mollers' investments consist of four portfolios of stocks and bonds. Mr. and Mrs. Moller own an investment portfolio individually and each receives income

* Judge Nichols assumed senior status effective October 1, 1983.

from a portfolio held in trust. However, they have full management control of all four portfolios, including those held in trust.

In 1976 and 1977 taxpayers devoted their full time to their investment activities. Each spent approximately 40–42 hours per week in connection with these activities. They kept regular office hours and monitored the stock market on a daily basis. They made all their investment decisions on their own. The total value of the four portfolios was $13,500,000 in 1976 and $14,500,000 in 1977.

The Mollers engaged in a variety of activities in managing their portfolios. They maintained a "watch list" listing all stocks on the New York Stock Exchange that were considered to be potential purchases. They kept detailed records of the stocks in their portfolios. They also subscribed to and regularly studied a number of financial publications and services.

The Claims Court concluded that taxpayers engaged in 83 security purchase transactions and 41 sales transactions in 1976 and 76 purchase and 30 sales transactions in 1977. Eight of the security purchase transactions in 1976 and nine in 1977 consisted of deposits to secure shares in interest-bearing common trust accounts; three transactions in 1976 and 23 in 1977 consisted of invasions by Mrs. Moller of her trust corpus; and 14 transactions in 1974 and nine in 1977 consisted of stocks acquired through splits and dividends. Twenty-two of the sales transactions in 1976 and seven in 1977 were withdrawals from common trust accounts.[1] The stocks which taxpayers sold in 1976 and 1977 had been held for an average of more than 3⅓ and 8 years, respectively.

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[1]Because the deposits, the corpus invasions, the stock splits, and the withdrawals are not market transactions equivalent to the purchasing and selling of stocks, the number of purchases should actually be 58 in 1976 and 35 in 1977 and the number of sales should be 19 in 1976 and 23 in 1977. Our decision does not depend, however, on a reduction in the number of transactions.

The taxpayers did not purchase stocks for speculative purposes. They were primarily interested in long-term growth potential and the payment of interest and dividends. Interest and dividend income was over 98% of their gross income in 1976 and 1977. In 1976 their income from the sale of securities was only $612, while in 1977 their sales resulted in a loss of $223.

The taxpayers also invested in Treasury Bills but they did so to maintain liquidity and earn interest. Of the taxpayers' 46 Treasury Bill transactions in 1976 and 1977, only 7 involved bills sold before maturity.

The Mollers maintained a summer and a winter residence. Each house had quarters in which the taxpayers conducted their investment activities. The taxpayers kept regular hours and used the quarters exclusively for investment activities.

In managing their portfolios, the taxpayers incurred expenses of $22,659.91 in 1976 and $29,561.69 in 1977, and deducted these on their joint income tax returns. The expenses attributable to maintaining the taxpayers' two home-offices amounted to $7,439.65 in 1976 and $7,247.21 in 1977.[2]

The Internal Revenue Service disallowed that portion of the claimed deductions based on the home-office expenses for both offices and asserted deficiencies against the taxpayers for the years 1976 and 1977.[3] The taxpayers paid the deficiencies and filed claims for refunds. After these claims were disallowed, the taxpayers brought this action seeking recovery of the taxes paid, plus interest.

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[2]The home-office expenses included depreciation, utilities, insurance, and various maintenance expenses attributable to the offices.

[3]The other investment expenses amounting to $15,220.26 for 1976 and $22,314.48 for 1977 included subscriptions, office supplies, accounting and legal services, and other similar items. There is no dispute that taxpayers are entitled to deduct these expenses under I.R.C. § 212.

The Claims Court held that taxpayers were investors, not traders, but were nevertheless engaged in the trade or business of making investments and therefore entitled to deduct their home-offices expenses under section 280A of the Internal Revenue Code.

OPINION

I

Section 280A was added to the Internal Revenue Code of 1954 by the Tax Reform Act of 1976, Pub.L. No. 94-455, 90 Stat. 1520, to provide "definitive rules * * * governing the deductibility of expenses attributable to the maintenance of an office in the taxpayers' personal residence." S.Rep. No. 94-938, 94th Cong., 2d Sess. 144, 147, *reprinted in* 1976 U.S.Code Cong. & Ad. News 2897, 3576, 3579; H.R.Rep. No. 94-658, 94th Cong., 2d Sess. 157, 160, *reprinted in* 1976 U.S.Code Cong. & Ad.News 2897, 3050, 3058. Section 280A generally disallows all deductions for a taxpayer's use of a residence. Section 280A(c)(1)(A), however, provides an exception to this rule for that portion of the residence used as "the principal place of business for any trade or business of the taxpayer."[4]

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[4]Section 280A provides in pertinent part:

DISALLOWANCE OF CERTAIN EXPENSES IN CONNECTION WITH BUSINESS USE OF HOME, RENTAL OF VACATION HOMES, ETC.

(a) General Rule.—Except as otherwise provided in this section, in the case of a taxpayer who is an individual or an S corporation, no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence.

* * * * * * *

(c) Exceptions for Certain Business or Rental Use; Limitation on Deductions for Such Use.—

(1) Certain business use.—Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis—

(A) the principal place of business for any trade or business of the taxpayer, * * *.

In order to get a deduction under section 280A, a taxpayer must conduct an activity which is a trade or business, the principal office of which is in his home.[5] Prior to the enactment of section 280A, home-office expenses could have been deducted either under I.R.C. § 162(a), if incurred in carrying on a trade or business, or under I.R.C. § 212 if incurred for the production of income. The legislative history of section 280A makes clear that a taxpayer can no longer take a home-office deduction for an activity where it is for the production of income within the meaning of section 212 but is not a "trade or business" under section 162. S.Rep. No. 94-938 at 149, U.S.Code Cong. & Ad.News at 3581. *See Curphey v. Commissioner*, 73 T.C. 105 (1980).

The principal question in the instant case is whether the taxpayers' investment activity was a trade or business.

II

Neither the Internal Revenue Code nor the regulations define "trade or business." However, the concept of engaging in a trade or business, as distinguished from other activities pursued for profit, has been in the Internal Revenue Code since its inception and has generated much case law.

In determining whether a taxpayer who manages his own investments is engaged in a trade or business, the courts have distinguished between "traders," who are considered to be engaged in a trade or business, and "investors," who are not. *See, e.g., Levin v. United States*, 597 F.2d 760, 765 (Ct.Cl.1979). Contrary to the holding of the trial court, investors are considered to be merely

[5]There is also the statutory requirement that the office be "exclusively used on a regular basis." The government concedes that this requirement has been met.

engaged in the production of income. *See Purvis v. Commissioner*, 530 F.2d 1332 (9th Cir.1976).

This court's predecessor, the Court of Claims, has defined a trader as one whose profits are derived from the "direct management of purchasing and selling." *Levin* 597 F.2d at 765. The Ninth Circuit has adopted a similar test to distinguish between investment and trading accounts:

> In the former, securities are purchased to be held for capital appreciation and income, usually without regard to short-term developments that would influence the price of securities on the daily market. In a trading account, securities are bought and sold with reasonable frequency in an endeavor to catch the swings in the daily market movements and profit thereby on a short term basis.

Purvis, 530 F.2d at 1334, quoting *Liang v. Commissioner*, 23 T.C. 1040, 1043 (1955).

Therefore, in order to be a trader, a taxpayer's activities must be directed to short-term trading, not the long-term holding of investments, and income must be principally derived from the sale of securities rather than from dividends and interest paid on those securities. In determining whether a taxpayer who manages his own investments is a trader, and thus engaged in a trade or business, relevant considerations are the taxpayer's investment intent, the nature of the income to be derived from the activity, and the frequency, extent, and regularity of the taxpayer's securities transactions. *See Purvis*, 530 F.2d at 1334.

The Claims Court concluded that taxpayers were investors and not traders because they were primarily interested in the long-term growth potential of their stocks. We agree. Mr. Moller testified that he was looking

for long-term growth and the payment of dividends. In addition, the taxpayers did not derive their income from the relatively short-term turnover of stocks, nor did they derive any significant profits through the act of trading. Interest and dividend income was over 98% of taxpayers' gross income for 1976 and 1977, and in 1976 their profit from the sale of securities was only $612, while in 1977 their sales resulted in a loss of $233.

The number of sales transactions made by the taxpayers also leads to the conclusion that they were not traders in securities. In the cases in which taxpayers have been held to be in the business of trading in securities for their own account, the number of their transactions indicated that they were engaged in market transactions on an almost daily basis. *See Levin*, 597 F.2d at 765; *Fuld v. Commissioner*, 139 F.2d 465 (2d Cir.1943). At most, the Mollers engaged in 83 security purchase transactions and 41 sales transactions in 1976 and 76 purchase and 30 sales transactions in 1977.[6]

Moreover, taxpayers did not "endeavor to catch the swings in the daily market movements and profit thereby on a short term basis." *Purvis*, 530 F.2d at 1334. The stocks owned by taxpayers, which they sold during 1976 and 1977, had been held for an average of over 3½ and 8 years, respectively.

The Mollers were investors and not traders. The Claims Court so concluded and we agree.

III

The Claims Court, however, went on to hold that despite the fact that the Mollers were investors, they were in the trade or business of making investments. The court distinguished between passive and active investors and concluded that the Mollers were active investors engaged

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[6]See footnote 1 *infra*.

in a trade or business because their investment activities were regular, extensive, and continuous, and they involved the active and constant exercise of managerial and decision-making functions. We disagree.

A taxpayer who merely manages his investments seeking long-term gain is not carrying on a trade or business. This is so irrespective of the extent or continuity of the transactions or the work required in managing the portfolio. *Higgins v. Commissioner*, 312 U.S. 212, 61 S.Ct. 475, 85 L.Ed. 783 (1941). The fact that the Mollers spent much time managing a large amount of money is not determinative of the question whether they were engaged in a trade or business.

In *Higgins* a taxpayer who resided abroad maintained an office in the United States to handle bookkeeping and other details of his extensive security transactions. The taxpayer directed these activities from abroad. He sought primarily permanent investments but did make changes in his portfolio. Despite the fact that the taxpayer devoted a considerable amount of time to overseeing his securities, the Court held that his securities activities did not constitute a trade or business:

> The petitioner merely kept records and collected interest and dividends from his securities, through managerial attention for his investments. No matter how large the estate or how continuous or extended the work required may be, such facts are not sufficient as a matter of law to permit the courts to reverse the decision of the Board.

312 U.S. at 218, 61 S.Ct. at 478.

The Claims Court, relying on *Kales v. Commissioner*, 101 F.2d 35 (6th Cir.1939), distinguished the *Higgins* case on the basis that the taxpayer's activities in *Higgins* "were not at all comparable to the regular, extensive, and continuous activities of the plaintiffs in this

cr e." In *Kales*, the Sixth Circuit held that a taxpayer was engaged in the trade or business of managing her own investments because her management activities were "extensive, varied, regular and continuous." 101 F.2d at 39. However, in a subsequent case, the Sixth Circuit recognized that "the decision in *Kales* was impliedly if not expressly disapproved in *Higgins* * * *." *Goodyear Investment Corp. v. Campbell*, 139 F.2d 188, 191 (1943).[7]

The Claims Court erred in relying on the *Kales* case. The "regular, extensive, and continuous" test is not in itself the correct test for determining whether a taxpayer is engaged in the trade or business of managing his own investments. In *Higgins*, the Court stated that continuity and extent of investment activity were not determinative of the question of whether a taxpayer who manages his own investment is engaged in a trade or business. In a subsequent case, *Whipple v. Commissioner*, 373 U.S. 193, 83 S.Ct. 1168, 10 L.Ed.2d 288 (1963), the Court stated that it had established a definition of trade or business in *Higgins* and went on to explain the import of the case:

> In response to the *Higgins* case and to give relief to Higgins-type taxpayers ... Section 23(a) (now I.R.C. § 162) was amended not by disturbing the Court's definition of "trade or business" but by following the pattern that had been established since 1916 of "[enlarging] the category of incomes with reference to which expenses were deductible" ... to include expenses incurred in the production of income.

373 U.S. at 200, 83 S.Ct. at 1172.

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[7]The Supreme Court granted certiorari in *Higgins* to resolve the conflict between the Sixth Circuit's decision in *Kales* and the Second Circuit's decision in *Higgins v. Commissioner*, 111 F.2d 795 (2nd Cir. 1940), which it affirmed. 312 U.S. at 215 n. 5, 61 S.Ct. at 477 n. 5.

The Internal Revenue Code, however, does not provide that all expenses incurred in the production of income are deductible expenses. In *Whipple,* section 166, which restricts bad debt deductions to those incurred in a trade or business, as section 280A restricts home-office deductions to expenses incurred in a trade or business, was at issue. In denying the taxpayer a deduction because the bad debt was incurred in an activity entered into for profit, and not in a trade or business, the Court stated: "[w]hen the only return is that of an investor, the taxpayer has not satisfied his burden of demonstrating that he is engaged in a trade or business since investing is not a trade or business * * *." 373 U.S. at 202, 83 S.Ct. at 1174.

The Court of Claims, relying on *Higgins,* has also stated: "Managing one's own investments in securities is not the carrying on of a trade or business, irrespective of the extent of the investments or the amount of time required to perform the managerial functions." *Wilson v. United States,* 376 F.2d 280, 293 (1967).

In the instant case, taxpayers were not engaged in a trade or business. They were active investors in that their investment activities were continuous, regular, and extensive. However, this is not determinative of the issue and it is not the correct test. What is determinative is the fact that the taxpayers' return was that of an investor: they derived the vast majority of their income in the form of dividends and interest; their income was derived from the long-term holding of securities, not from short-term trading; and they were interested in the capital appreciation of their stocks, not short-term profits. Merely because taxpayers spent much time managing their own sizeable investments does not mean that they were engaged in a trade or business.

CONCLUSION

Although taxpayers' investment activity was entered into for the production of income, it did not rise to the level of a trade or business. Section 280A restricts home-office deductions to expenses incurred in the carrying on of a trade or business. Therefore, taxpayers were not entitled to a deduction under this section.

Because we decide this case on the grounds that taxpayers were not engaged in the trade or business of making investments, we need not and do not reach the issue of whether they could deduct the expenses of both their home-offices as their "principal place of business."

Accordingly, the judgment of the Claims Court is reversed.

REVERSED.

Joseph A. & Dorothy D. MOLLER

v.

The UNITED STATES.

No. 208-81T.

United States Claims Court.

Nov. 19, 1982.

As Amended Dec. 13, 1982.

OPINION

WHITE, Judge.

This case is related to the considerable number of cases in which courts, through the years, have dealt with the problem of whether taxpayers, in determining their income tax liabilities, may properly deduct from gross income expenses incurred by the taxpayers in connection with the management of their investments.

A common question in such cases is whether the activities of a taxpayer with respect to his investments constitute the carrying on of a "trade or business," as the pertinent provision of the Internal Revenue Code (now contained in 26 U.S.C. § 162(a)) states in part that "* * * [t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *." In this case, because of its unusual facts, the question just stated must be answered in the affirmative.

In the present case, Joseph A. and Dorothy D. Moller (plaintiffs) are husband and wife, and they are residents of Scottsdale, Arizona. During 1976 and 1977, the plaintiffs actively managed four separate portfolios of stocks and other securities, and, in doing so, they incurred expenses totaling $22,659.91 in 1976 and $29,561.69 in 1977.

The 1976 expenses included $5,832.88 as the cost of maintaining an office in the plaintiffs' principal residence at Scottsdale and $1,606.77 as the cost of maintaining a second office in the plaintiffs' summertime residence at Santa Barbara, California. The 1977 expenses included $5,350.55 as the cost of maintaining the office in Scottsdale and $1,896.66 as the cost of maintaining the office in Santa Barbara.

In preparing and filing their joint income tax returns for 1976 and 1977, the plaintiffs deducted from gross income the respective amounts which they had expended during 1976 and 1977 in connection with the management of the four portfolios.

On audit, the Internal Revenue Service (IRS) disallowed the portions of the plaintiffs' deductions based on the costs involved in maintaining the Scottsdale and Santa Barbara offices; and the IRS assessed deficiencies in income taxes, plus interest thereon, for 1976 and 1977.

The plaintiffs paid the deficiencies and interest, sought refunds from the IRS, and, having failed to secure administrative relief, filed the present action.

The Government has conceded that the office expenses with which the court is concerned in the present case were "ordinary and necessary expenses," but the Government disputes the plaintiffs' contention that they were carrying on a "trade or business" during the years in question.

The answer to the question of whether a taxpayer was carrying on a "trade or business" during a taxable period must be determined on the facts of the particular case. *Higgins v. Commissioner*, 312 U.S. 212, 217, 61 S.Ct. 475, 478, 85 L.Ed. 783 (1941); *Chang Hsiao Liang v. Commissioner*, 23 T.C. 1040, 1045 (1957). Consequently, in resolving the issue that is before the court in the present

action, it is necessary to set out in considerable detail the facts concerning the plaintiffs' investment activities.

It has been mentioned earlier in the opinion that, during 1976 and 1977, the plaintiffs were actively engaged in the management of four portfolios of stocks and other securities. The same four portfolios were managed by the plaintiffs before 1976, and the plaintiffs have continued to manage them since 1977. One of these portfolios consists of securities held by the plaintiff Joseph A. Moller (Mr. Moller) individually, a second consists of securities held by the plaintiff Dorothy D. Moller (Mrs. Moller) individually, a third consists of securities held by Northern Trust No. 1-29551 (Northern Trust), and the fourth consists of securities held by the First Interstate Bank Trust No. 50-50-0224 (First Interstate Trust).

In 1976, the total value of all four portfolios was approximately $13,500,000. In 1977, the total value of the four portfolios was approximately $14,500,000.

The First Northern Trust originated through stock put in trust for Mrs. Moller by her former husband. She is entitled to receive the income from this trust during her lifetime; and, upon her death, the corpus will pass to the other heirs of her former husband.

The First Interstate Trust originated through stock put in trust by Mr. Moller's first wife (now deceased). Mr. Moller receives the income from this trust during his lifetime; and, upon his death, the corpus will pass to the children of his first marriage.

The Northern Trust Company is the trustee of the Northern Trust. Mr. Moller is the trustee of the First Interstate Trust. However, Mr. and Mrs. Moller make all the investment decisions in regard to both of the trusts, as well as with respect to the two portfolios held by them individually.

During 1976 and 1977, the plaintiffs devoted their full time to their investment activities; and each regularly spent between 40 and 42 hours per week in conducting such activities. The plaintiffs kept regular office hours and, on a daily basis, monitored the stock market and their four portfolios. This included studying the performance of the securities held in the four portfolios, and also the performance of securities that were regarded as prospects for purchase and inclusion in the portfolios.

With respect to the stocks that were considered as candidates for purchase, the plaintiffs maintained the following records on a current basis:

(1) A watch list, listing all stocks on the New York Stock Exchange that were considered to be candidates for possible purchase. This list was updated at least once or twice per week.

(2) A book of product research notes, containing information concerning the product of the industry in which any company under study was engaged. These notes contained definitions and information concerning product uses, manner of use, and supply and sales market data for the product.

(3) A portfolio information book, containing information on stocks promoted from the watch list but not yet purchased. These were stocks which were more actively and closely followed than those on the watch list. They were highly eligible for purchase and, depending on the circumstances, would probably be purchased.

Before a decision was made by the plaintiffs to purchase a stock, it was generally watched by the plaintiffs for a period of between 2 to 6 months; and often a stock was watched as long as 1 year.

The monitoring and study of stocks held in the four portfolios included the assembly and maintenance

of information regarding the corporations invested in, their products, and their performance. The following records on such stocks were maintained by the plaintiffs on a current basis:

(1) A stock note data book which contained an alphabetical list of the stocks held and included the earning percentage of each company's product in its market and the company's profit percentage in that market, as well as other information which would affect the value of the stock.

(2) A stock record book for each portfolio, listing all stocks currently held, in which entries were made whenever a stock was purchased.

(3) A current stock purchase book, containing a sheet for each stock, prepared on the date of purchase, recording the number of shares purchased, the date of purchase, and the cost. A master sheet was made up of these purchases, to indicate the stock-of-record dates so that the plaintiffs could determine whether dividends would be paid on the current purchases. The sheet made up for each stock was placed in the stock record book only when the stock certificate was received. On receipt of the stock certificate, the certificate number and the date were recorded on the stock purchase sheet and inserted in the stock record book.

(4) Current capital gains records, which provided a detailed record of gains and losses.

(5) Dividend record books, indicating the number of shares held in each stock, the dividend for each, and the total dividend, as well as the information from Forms 1099 at the end of each year to check those totals against the dividend record books' totals.

The plaintiffs kept the following records on a current basis both for stocks held and for stocks that were being considered for purchase:

(1) Stock purchase worksheets, which were projections for stocks based on study and the daily quotations. These sheets contained projections for possible use in examining options of purchasing one stock as opposed to another, the likely stocks to be sold if cash were to be needed, and the relative desirability of various stocks. The stocks to be purchased were drawn from this list.

(2) Market information on all securities held in the portfolios and on some securities that were being watched for possible purchase, including certain securities which might have been held in the past and were regarded as candidates for repurchase. The weekly price for each stock as of the close of the market on Friday night was entered, as well as the type of stock, its rating, symbol, and range of prices, and an indication of the last purchase.

The plaintiffs made all of their investment decisions "on their own." They did not employ an investment advisor, and they did not seek investment advice from their stockbroker.

In order to assist them in their investment studies and decisions, the plaintiffs subscribed to and regularly studied a number of publications and services. Three of these (including the Wall Street Journal) were received on a daily basis, 10 were received on a weekly basis, three were received on a monthly basis, and five were received on a quarterly basis. In addition, the plaintiffs also received and studied the annual reports of companies in which they were interested. Mr. Moller studied these materials between 8 and 10 hours a week, and Mrs. Moller studied them between 7 and 8 hours per week. The cost of the publications and services to which the plaintiffs subscribed was approximately $1,800 in 1976 and $2,400 in 1977.

The plaintiffs engaged in 83 security purchase transactions in 1976 and in 76 such transactions in 1977.

The total dollar amounts of these transactions were $1,844,669 in 1976 and $958,073 in 1977.[1]

The plaintiffs invested in Treasury Bills any funds which were not currently committed to stocks, in order to maintain the liquidity of those funds, while still producing revenue. The 1976 and 1977 transactions in Treasury Bills, including roll-overs of Treasury Bills that matured during those years, involved total dollar volumes of $2,561,739 in 1976 and $1,500,042 in 1977. The plaintiffs maintained a sheet on which the Treasury Bills were recorded, together with the amounts and the dates on which they would become due, and also a Treasury Bills transaction summary, indicating purchases, sales, and dates of sale and purchase, as well as the amounts involved.

In 1976, the plaintiffs engaged in 41 transactions involving sales of securities.[2] The total dollar amount of these transactions in 1976 was $1,679,813. In 1977, the plaintiffs engaged in 30 transactions involving sales of securities.[3] The dollar amount involved in the 1977 sale transactions was $821,028. The stocks sold in 1976 and 1977 had been held for an average of more than 3½ years and 8 years, respectively.

During 1976 and 1977, the portfolios included stocks that were neither purchased nor sold during those years, but were retained during the period. A decision to

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[1]Eight of the security purchase transactions in 1976 and nine in 1977 consisted of deposits to secure shares in interest-bearing common trust accounts at Northern Trust Company; three transactions in 1976 and 23 in 1977 consisted of invasions by Mrs. Moller of the corpus of the Great Northern Trust (she could invade the corpus annually to the extent of 5 percent); and 14 transactions in 1976 and nine in 1977 consisted of stocks acquired through splits and stock dividends.

[2]This figure includes 22 withdrawals from common trust funds.

[3]This figure includes seven withdrawals from common trust funds.

retain a stock was a continuing one, and involved a study (1) of the administration of the corporation, (2) of the corporation's outlook, plans, and spending levels for development, (3) of the acceptance of the corporation's product in the market place, *i.e.*, whether such product was growing or lessening in importance, and (4) of the price-earning ratio of the stock. As the plaintiffs were attempting to minimize risk and maximize long-term growth, the decision to hold a stock was equally as important as a decision to buy or sell a stock.

The plaintiffs maintained telephone contact with their broker at E.F. Hutton & Company every other day, on the average. On days of active trading, 10 or 15 calls per day could be placed to the broker, and, on less active days, one or two calls a day could be placed. The plaintiffs' account with E.F. Hutton & Company was the largest account of that firm's local office, being larger than the accounts which any of the local banks had with the firm.

Ever since 1965, the plaintiffs have relied almost wholly on their income from investments for their livelihood. Their only other sources of income have been two small pensions and social security.

The plaintiffs' income from dividends and interest (*i.e.*, from investments) has steadily increased through the years. In 1976, their income from dividends and interest amounted to $543,265, and their federal income tax amounted to $297,745. In 1977, the plaintiffs' income from dividends and interest amounted to $590,762, and their federal income tax amounted to $316,721.

The plaintiffs maintained five separate bank accounts in connection with their investment activities. One of these bank accounts was for the payment of expenses incurred in the conduct of such activities.

During the 1976–77 period (as well as before and after that period), the plaintiffs conducted their invest-

ment activities (except during the summertime) in a well-equipped office which they maintained in Scottsdale. They were assisted in such activities by a secretary/bookkeeper, who worked approximately 22 hours per week and whose work related almost wholly to the plaintiffs' investment activities. The office consisted of two rooms, and contained a desk for Mr. Moller, a desk for Mrs. Moller, a desk for the secretary/bookkeeper, calculating and reproduction machines, filing cabinets, a typewriter, a checkwriter, a postage meter, and a 2-drawer filing cabinet for current files. All of the books, records, documents, publications, and services previously described were stored in this office.

At all times pertinent to this case, the plaintiffs also maintained a similarly equipped office in Santa Barbara, California, except that their permanent files remained in Scottsdale. The plaintiffs spent (and they still spend) their summers in Santa Barabara. They performed the same sort of investment activities in their Santa Barbara office that they performed in their Scottsdale office.

The plaintiffs' Scottsdale and Santa Barbara offices were used exclusively for their investment activities. As stated earlier in the opinion, each of the plaintiffs devoted between 40 and 42 hours per week to such activities. (The plaintiffs' offices will be mentioned again at a later point in the opinion.)

The facts, as previously summarized, indicate that the plaintiffs would not qualify as traders in the securities market. A trading account has been defined as one in which "securities are bought and sold with reasonable frequency in an endeavor to catch the swings in the daily market movements and profit thereby on a short-term basis." *Chang Hsiao Liang v. Commissioner, supra,* 23 T.C. at 1043. The plaintiffs in this case were investors

rather than traders, as they were primarily interested in long-term growth and the payment of dividends by the companies in which they invested.

In dealing with the deductibility of expenses incurred by investors in the management of their investments, the decided cases have tended to distinguish "between a passive investor and one whose activities place him in the category of those carrying on business * * *." *Kales v. Commissioner,* 101 F.2d 35, 38 (6th Cir.1939).

The facts clearly show that the plaintiffs were anything but "passive" investors. On the contrary, their investment activities were regular, extensive, and continuous, and they involved the active and constant exercise of managerial and decision-making functions.

The plaintiffs in this case have made a substantially better showing in support of their contention that they were carrying on a business during the period in question than did the taxpayer in the *Kales* case, previously cited. In that case, the taxpayer was a woman of considerable means who had inherited from her father valuable real estate and stocks in 46 corporations. She had an arrangement with a law firm whereby her books were kept by the firm's bookkeeping staff, and she paid $3,000 a year for this service. The firm set aside an office where the taxpayer could confer with the head bookkeeper, and she visited the office three or four times a week for this purpose. She made all the decisions effecting either the purchase or the sale of her securities. During a 14-year period, the taxpayer purchased bonds in the aggregate amount of more than $11,665,000, bonds were sold or matured in the aggregate amount of over $3,000,000, and stocks were purchased in the aggregate amount of approximately $500,000.

In successfully suing to recover income taxes which she was required to pay pursuant to deficiency

assessments, Mrs. Kales expended a considerable sum for attorney fees and other expenses. The Court of Appeals held that such expenses were deductible for income tax purposes, stating (101 F.2d at 39):

> Concluding that there are cases where the activities of taxpayers are such that though they invest but their own capital they are none the less carrying on a business, we think that Mrs. Kales' activities bring her deductions within the permissible scope of the statute. * * *

The court also said (*id.* at 39) in this connection that it was "sufficient to say that * * * [the taxpayer's activities] were extensive, varied, continuous and regular * * *."

The plaintiffs' offices were well-equipped and personally maintained by the plaintiffs, and not borrowed office space such as that used by Mrs. Kales; the plaintiffs kept regular office hours each working day and devoted from 40 to 42 hours per week to their investment activities, instead of merely visiting the office three or four times a week as Mrs. Kales did; the plaintiffs devoted their full time to their investment activities and each day carefully monitored the stock market and their four portfolios of stocks, which Mrs. Kales apparently did not do; the plaintiffs subscribed to and carefully studied numerous publications and services in order to keep abreast of developments in the stockmarket, which apparently Mrs. Kales did not do; and the plaintiffs kept elaborate, up-to-date records on the performance of the stocks in which they had invested, and also of stocks which they regarded as possible candidates for purchase, which Mrs. Kales apparently did not do. Accordingly, the plaintiffs' investment activities were certainly more "extensive, varied, continuous and regular" than were the investment activities of Mrs. Kales, who was allowed to deduct her investment expenses.

It must be noted that the Supreme Court once said that "investing is not a trade or business." *Whipple v. Commissioner,* 373 U.S. 193, 202, 83 S.Ct. 1168, 1174, 10 L.Ed.2d 288 (1963). This statement, however, should be considered in context. The *Whipple* case did not involve expenses incurred in the management of a portfolio of securities. The taxpayer in that case organized, owned the controlling interest in, and managed a bottling company (among other companies). He sold equipment on credit to the bottling company; the indebtedness became worthless; and he deducted it as a business bad debt in computing taxable income. In holding that the deduction was improper, the Court stated in part as follows (373 U.S. at 202, 83 S.Ct. at 1174):

> Devoting one's time and energies to the affairs of a corporation is not of itself, and without more, a trade or business of the person so engaged. Though such activities may produce income, profit or gain in the form of dividends or enhancement in the value of an investment, this return is distinctive to the process of investing and is generated by the successful operation of the corporation's business as distinguished from the trade or business of the taxpayer himself. When the only return is that of an investor, the taxpayer has not satisfied his burden of demonstrating that he is engaged in a trade or business since investing is not a trade or business and the return to the taxpayer, though substantially the product of his services, legally arises not from his own trade or business but from that of the corporation. Even if the taxpayer demonstrates an independent trade or business of his own, care must be taken to distinguish bad debt losses arising from his own business and those actually arising from activities peculiar to an investor concerned with, and participating in, the conduct of the corporate business.

Consideration should also be given to the Supreme Court's decision in *Higgins v. Commissioner*, 312 U.S. 212, 61 S.Ct. 475, 85 L.Ed. 783 (1941). In that case, the taxpayer lived in Paris, France, but he had extensive investments (real estate and securities) in this country. To assit him in the management of his financial affairs, the taxpayer maintained an office in New York City, staffed by four employees, and an office in Paris, staffed by the taxpayer's secretary. The activities of the New York City office related principally to the taxpayer's real estate holdings, particularly the rental of buildings, but they also related to the taxpayer's securities. There was no controversy before the Court about the deductibility of the office expenses insofar as they were allocable to the management of the plaintiff's real estate. The controversy related to the portion of the office expenses allocable to the management of the taxpayer's securities.

Through correspondence, the taxpayer in the *Higgins* case kept a watchful eye over his securities. However, as his portfolio consisted mostly of permanent investments, there were only limited shiftings in his portfolio. The activities in connection with the securities were performed by the taxpayer's New York City office, which kept records, received the relatively few securities that were purchased pursuant to the taxpayer's instructions, received dividend and interest checks, made deposits, and forwarded weekly and annual reports to the taxpayer.

In holding that the taxpayer's office expenses in the *Higgins* case were not deductible for income tax purposes insofar as the expenses were allocable to the management of the taxpayer's securities, the Court stated in part as follows (312 U.S. at 218, 61 S.Ct. at 478):

> * * * The Commissioner [of Internal Revenue] and the Board [of Tax Appeals] appraised the evidence here as insufficient to establish

> petitioner's activities as those of carrying on a business. The petitioner merely kept records and collected interest and dividends from his securities, through managerial attention for his investments. No matter how large the estate or how continuous or extended the work required may be, such facts are not sufficient as a matter of law to permit the courts to reverse the decision of the Board. * * *

The activities of the taxpayer and his employees in the *Higgins* case, insofar as the management of the taxpayer's securities was concerned (they "merely kept records and collected interest and dividends from his securities"), were not at all comparable to the regular, extensive, and continuous activities of the plaintiffs in this case with respect to the four portfolios of securities which they managed. Consequently, the facts of the *Higgins* case are readily distinguishable from the facts of the present case.

Other cases in which investors received unfavorable court decisions can also be distinguished from the present case. For example, in *Snyder v. Commissioner*, 295 U.S. 134, 55 S.Ct. 737, 79 L.Ed. 1351 (1935), the taxpayer did not devote a substantial part of his business day to his stock transactions. In *Deputy v. Du Pont*, 308 U.S. 488, 60 S.Ct. 363, 84 L.Ed. 416 (1940), the taxpayer's expenses were not "ordinary and necessary expenses." In *Wilson v. United States*, 179 Ct.Cl. 725, 376 F.2d 280 (1967), one taxpayer devoted an average of only 2 or 3 hours a day, and another taxpayer devoted an average of only 3 or 4 hours per week, to the management of their securities portfolio. In *Kane v. Commissioner*, 100 F.2d 382 (2d Cir.1938), the evidence did not show to what extent there was activity in buying or selling securities. In *Miller v. Commissioner*, 102 F.2d 476 (9th Cir.1939), there was no evidence relating either to the number or to the extent of the taxpayer's dealings in securities. In *Purvis*

v. Commissioner, 530 F.2d 1332 (9th Cir.1976), the taxpayer did not maintain a separate bank account, or office, or personnel in connection with his transactions in securities; his study of the stock market consisted of visiting brokers' offices three or four times a week to observe the market; and his income tax returns consistently indicated that his occupation was that of an attorney.

On the basis of the unusual facts in this case, it is concluded, and found as a fact, that the plaintiffs' office expenses were ordinary and necessary expenses incurred in carrying on a business.

As mentioned earlier in the opinion, the plaintiffs' expenses with which the court is concerned in this case were expenses incurred in connection with the maintenance of offices in the plaintiffs' residences at Scottsdale and Santa Barbara. Accordingly, it is necessary to refer to 26 U.S.C. § 280A, which provides in part as follows:

> (a) General rule.—Except as otherwise provided in this section, in the case of a taxpayer who is an individual * * *, no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence.
>
> * * * * * * *
>
> (c) Exceptions for certain business or rental use * * *.—
>
> (1) Certain business use.—Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis—
>
> (A) the principal place of business for any trade or business of the taxpayer.

It has already been determined that the plaintiffs were carrying on a business during the taxable period

involved in this case. The facts show that the offices in their Scottsdale and Santa Barbara homes were the plaintiffs' principal place of business, as virtually all of their investment activities were conducted in the respective offices, depending on the seasons of the year.

Also, the facts show that the two offices were used exclusively for business purposes. The plaintiffs did not entertain there, and guests did not go there. Other parts of the respective residences were used for such purposes.

In addition, the facts show that the offices were used regularly for business purposes. The plaintiffs kept regular office hours there each working day, and each devoted from 40 to 42 hours per week to their investment activities.

Accordingly, the plaintiffs' use of offices in their Scottsdale and Santa Barbara residences came within the exception previously quoted from 26 U.S.C. § 280A(c)(1)(A), and the expenses incurred in maintaining the offices are deductible for income tax purposes.

It necessarily follows that the plaintiffs are entitled to recover. The determination of the amount of the recovery will be determined in subsequent proceedings under Rule 42(c).

CONCLUSION OF LAW

On the facts, as found by the court, the court concludes as a matter of law and decides that the plaintiffs are entitled to recover, together with interest computed in accordance with section 6611 of the Internal Revenue Code of 1954. The determination of the amount of the plaintiffs' recovery is reserved for further proceedings under Rule 42(c), after which a final judgment will be entered.

JOSEPH A. & DOROTHY D. MOLLER,
Appellees,

v.

THE UNITED STATES,
Appellant.

No. 83-870

United States Court of Appeals
for the Federal Court

ORDER

A petition for rehearing and a suggestion for rehearing en banc having been filed in this case,

UPON CONSIDERATION THEREOF, it is Ordered by the court that the petition for rehearing be, and the same is hereby,

Denied.

The suggestion for rehearing en banc is declined.

FOR THE COURT:

/s/ _____
George E. Hutchinson, Clerk

December 13, 1983
DATE

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 280A. DISALLOWANCE OF CERTAIN EXPENSES IN CONNECTION WITH BUSINESS USE OF HOME, RENTAL OF VACATION HOMES, ETC.

(a) *General Rule.* — Except as otherwise provided in this section, in the case of a taxpayer who is an individual or an electing small business corporation, no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence.

(b) *Exception for Interest, Taxes, Casualty Losses, Etc.*—Subsection (a) shall not apply to any deduction allowable to the taxpayer without regard to its connection with his trade or business (or with his income-producing activity).

(c) *Exceptions for Certain Business or Rental Use; Limitation on Deductions for Such Use.* —

(1) *Certain business use.* — Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis —

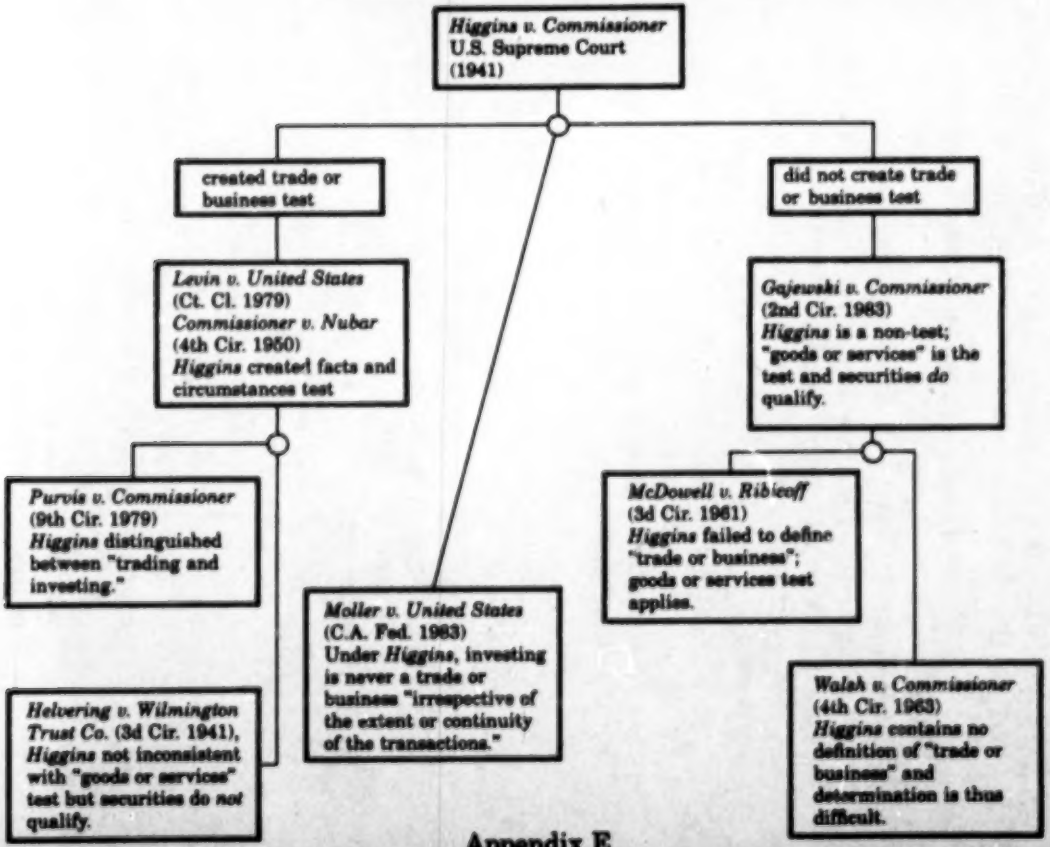
(A) [as] the principal place of business for any trade or business of the taxpayer,

(B) as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business, or

(C) in the case of a separate structure which is not attached to the dwelling unit, in connection with the taxpayer's trade or business.

* * * *

Conflicting Interpretations of *Higgins v. Commissioner*


Higgins v. Commissioner
U.S. Supreme Court
(1941)
created trade or business test
did not create trade or business test
Levin v. United States
(Ct. Cl. 1979)
Commissioner v. Nubar
(4th Cir. 1950)
Higgins created facts and circumstances test
Gajewski v. Commissioner
(2nd Cir. 1983)
Higgins is a non-test; "goods or services" is the test and securities *do* qualify.
Purvis v. Commissioner
(9th Cir. 1979)
Higgins distinguished between "trading and investing."
McDowell v. Ribicoff
(3d Cir. 1961)
Higgins failed to define "trade or business"; goods or services test applies.
Moller v. United States
(C.A. Fed. 1983)
Under *Higgins*, investing is never a trade or business "irrespective of the extent or continuity of the transactions."
Helvering v. Wilmington Trust Co. (3d Cir. 1941), *Higgins* not inconsistent with "goods or services" test but securities do *not* qualify.
Walsh v. Commissioner
(4th Cir. 1963)
Higgins contains no definition of "trade or business" and determination is thus difficult.

Appendix E

CERTIFICATE OF SERVICE

DAVID R. FRAZER certifies that he is a member of the Bar of this Court and the counsel of record for Petitioners in this cause; that on this _____ day of March, 1984, he mailed three (3) copies of Petitioners' Petition for a Writ of Certiorari in this cause by depositing same in the U.S. mail, first-class postage prepaid, to:

Solicitor General
Department of Justice
Washington, D.C. 20530

that all parties required to be served have been served, in compliance with Supreme Court Rule No. 28.

_____
David R. Frazer